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Steel Market Issues

The international steel industry will be in trouble for a long time. Even at the peak of the next business cycle OECD steel production will be 75-100 million tons below rated capacity. West European governments have aggressively acted to cushion the adverse economic impacts of overcapacity, including subsidizing steel exports to the Soviet Union and elsewhere. Growing reliance on Soviet business has strong implications for West European economic dependence on the Soviet market. Moreover, the willingness of West European and Japanese governments to provide subsidized financing that at present market rates could save Moscow some several billion in badly needed foreign exchange over the 1982-85 period.

Overcapacity

The OECD steel industry will be plagued by substantial overcapacity for the foreseeable future.

- o EC steel consumption is expected to remain under 100 million tons through 1985, while steel making capacity in the Community approaches 150 million tons.
- o Japanese steel capacity approaches 140 million tons, while production forecasts indicate a need for only 110 million tons.

The prospects for relief by export expansion are limited.

- o Exports to LDCs have leveled off as they steadily increase their level of steel self-sufficiency.

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- o EC exports to the US may be reduced by the imposition of countervailing duties.

Growing Soviet Demand for OECD Steel

Soviet need for OECD steel will continue to rise steadily over the medium term.

- o Moscow has had difficulty in adding to capacity, particularly for high-quality steel and specialized steel products.
- o Soviet imports have risen from \$2.5 billion in 1975 to \$3.5 billion in 1981; they would have been higher in the absence of hard currency constraints.

We believe that the Soviets would like to import \$17 billion to \$20 billion in steel products during 1981-85.

- o Imports of large-diameter pipe will be especially important to Soviet plans for building oil and gas pipelines. The Siberia-to-Europe line alone will require about 3 million tons of high quality steel pipe, which we believe the Soviets will not be able to produce in quantity during the 1980s.
- o Until at least the mid-1980s the USSR will also need to buy large quantities of cold-rolled sheet, tin plate, and various types of sheet products.

West European and Japanese Cultivation of the Soviet Market

West European and Japanese governments have steadily eased credit terms to boost steel exports to the USSR.

- o The Soviets have received credit extensions on completed deals.

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- o Large diameter pipe exports continue to carry attractive rates -- up to eight years at 7.25 percent interest.
- o The Italian government is negotiating to subsidize \$120 million in steel exports to the Soviet Union. Italy has raised the funds on the Eurocurrency market paying a spread of .75 over LIBOR; Moscow will pay a fixed 7.7 percent interest rate on the seven-year credit with the difference picked up by Rome.

Actual Deliveries

More generous terms, all else equal, will allow the Soviets to increase the volume of steel imports, thereby mitigating domestic economic constraints caused by steel shortages. Alternatively, it frees valuable foreign exchange for grain. The current situation may have a longer term impact as well. Foreign steel producers -- aware of the long-term nature of their problem -- may be willing to sign long-term supply agreements at favorable credit terms.

- o At present, 6 percent of Japanese steel exports and 15-18 percent of EC steel exports outside the Community go to the USSR.

The EC Question

The US action to restrict EC steel sales to the US market could further encourage sales to the USSR.

- o EC steel sales to the US currently account for 5 percent of output. About 30 percent of these exports will be affected by the imposition of countervailing duties resulting from the preliminary finding that EC

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steelmakers benefited from government subsidies.

- o Other suits, including dumping charges, against EC steelmakers are pending and may lead to additional duties on US imports of EC steel.

US actions against EC steelmakers do not have to be made final until early fall. The options before the US are limited:

- o The duties must be imposed unless the industry withdraws its suits; this is unlikely barring EC agreement to voluntarily restrict exports.
- o Even if the EC is willing to do this, the restrictions may not be severe enough to satisfy the US industry.

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